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No. 90-812

In The

Supreme Court of the United States

October Term, 1990

CALIFORNIA STATE BOARD OF EQUALIZATION,

Petitioner,

v.

HAROLD S. TAXEL, TRUSTEE IN BANKRUPTCY,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

Respondent Harold S. Taxel is the court-appointed trustee of the Chapter 7 bankruptcy estate of Sluggo's Chicago Style, Inc. ("Sluggo's"), the former owner of a pizza bar in San Diego, California.

On April 9, 1984, Sluggo's provided petitioner a certificate of deposit in the face amount of $9,100 to secure the payment of sales and use taxes pursuant to California Revenue & Taxation Code section 6701, which provides:

> The Board . . . may require any person . . . to place with it such *security* as the board may determine. (emphasis added)

On November 26, 1984, Sluggo's filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. The case was converted to a Chapter 7 proceeding on August 19, 1986.

During the pendency of the Chapter 11 proceeding, and without obtaining relief from the automatic stay which was then in effect pursuant to 11 U.S.C. section 362, petitioner cashed Sluggo's certificate of deposit. When petitioner refused to return the funds to respondent for distribution to creditors pursuant to Bankruptcy Code section 724(b),[1] respondent filed an adversary proceeding in the Bankruptcy Court to recover the funds for the benefit of the estate.

The United States Bankruptcy Court, the United States Bankruptcy Appellate Panel of the Ninth Circuit,

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[1] This section, which is quoted at pages 2-3, *infra*, sets out a system for distribution of property in which the estate has an interest but which is subject to a tax lien.

and the United States Court for Appeals of the Ninth Circuit all agree that the certificate of deposit was property of the estate, and that petitioner violated the automatic stay when it cashed the certificate of deposit.

Petitioner contends that the decisions of all three courts are wrong, and that Sluggo's certificate of deposit was in fact not Sluggo's property at all, but property of petitioner held in trust for Sluggo's (Pet. at 9). The question whether the certificate of deposit was petitioner's or respondent's property must be decided with reference to state, non-bankruptcy law. *Butner v. U.S.*, 440 U.S. 48, 54-55 (1979).

SUMMARY OF REASONS FOR DENYING THE WRIT

Petitioner's entire argument is grounded upon what it asserts is a misapplication by three courts of substantive California law. Thus, there is no issue of interest to the United States. For the same reason, there is no conflict among the circuits regarding these issues.

Further, respondent does not argue that petitioner is not entitled to receive a portion of the funds at issue. On the contrary, petitioner is entitled to receive a distribution from Sluggo's estate in accordance with the distribution schedule set forth in Bankruptcy Code section 724(b), which provides:

> Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for a tax . . . shall be distributed –

> (1) first, to any holder of an allowed claim secured by a lien . . . that is senior to such tax lien;
>
> (2) second, to any holder of a claim of a kind specified in section 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), or 507(a)(6) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien; [and]
>
> (3) third, to the holder of such tax lien . . . .

11 U.S.C. § 724(b).

Petitioner simply has no authority that one who provides security for future payment of indebtedness loses all interest in the security provided. Moreover, as the Ninth Circuit correctly held in this case, citing *Segal v. Rochelle*, 86 S.Ct. 511, 515 (1986), the term "property" is broadly interpreted for purposes of the Bankruptcy Code. Whether the certificate of deposit is labelled "security" (as Cal. Rev. & Tax. Code § 6701, quoted *infra*, expressly provides), a "future contingent interest" (the Ninth Circuit's opinion), or, as petitioner insists, a trust in which Sluggo's retained an interest, the three courts which have considered this case correctly concluded that the certificate was "property" of the bankruptcy estate.

I.

THERE ARE NO POLICY REASONS FOR GRANTING CERTIORARI IN THIS CASE.

A. THE DETERMINATION WHETHER A TRUST FUND EXISTED IS A MATTER OF STATE LAW WHICH THIS COURT NEED NOT REVIEW.

As petitioner correctly concedes at page 16 of its writ petition, "[w]hether or not a trust has been established is a matter of state law." *In re Crotts*, 81 B.R. 418, 420 (Bkrtcy.

E.D. Va. 1988). As the Bankruptcy Appellate Panel stated in deciding this case:

> Courts are to resolve the questions of whether a debtor has [an] interest in a given asset by reference to state, non-bankruptcy law. *In re Farmers Mkts., Inc.*, 792 F.2d 192 (9th Cir. 1981).

Since petitioner's entire argument turns on a question of state law, and since three competent courts have interpreted that law against petitioner, there is no compelling reason for this Court to again review this state law question.

B. THIS CASE DOES NOT INVOLVE A CONFLICT BETWEEN CIRCUITS.

Petitioner argues that there is a conflict between the Ninth and Sixth Circuits as to whether "a fund created by statute for the benefit of certain creditors of the debtor is a trust fund which is not property of the bankruptcy estate" (Pet. at 7-8). This is not correct.

Contrary to petitioner's argument, the Ninth Circuit's decision here does not conflict with the Sixth Circuit's decision in *Selby v. Ford Motor Co.*, 590 F.2d 642 (6th Cir. 1979).

Selby concerned a Michigan statute which *expressly* identified a builder's construction fund as a trust fund. In this case, California Revenue & Taxation Code section 6701 expressly identifies Sluggo's certificate of deposit, not as a trust fund, but as "*security*." Further, in this case the Ninth Circuit found it unnecessary to determine whether petitioner held Sluggo's funds in trust because it found that the money constituted "property" within the

meaning of Bankruptcy Code section 541. Section 541(a)(1) of the code defines property of the estate to include "all legal or equitable interests of the debtor in property as of the commencement of the case." As this Court noted in *United States v. Whiting Pools, Inc.*, 402 U.S. 198, 206-07 (1983), property of a bankruptcy estate can include assets against which taxing authorities hold a lien.

This case and *Selby* present different facts and involve the interpretation of different state statutes. Those statutes do not require reinterpretation by this Court.

II.

THE COURTS BELOW FULLY CONSIDERED AND CORRECTLY DECIDED THE STATE LAW ISSUE RAISED BY PETITIONER.

Petitioner's argument is summarized at page 9 of its writ petition:

> Thus, on April 9, 1984, the above certificate of deposit became the property of the Board subject only to the Board's obligation to use such certificate in the manner required by law.

The conclusion that Sluggo's certificate of deposit "became the property of the Board" is erroneous. As noted by each of the courts below, the very statute under which petitioner concedes it held Sluggo's money refers to the funds required to be deposited as "security."

Moreover, the requirement that the Board "use such certificate in the manner required by law" conclusively

shows that the funds did not belong to petitioner. California Revenue & Taxation Code sections 6701 and 6815 preclude petitioner from cashing such security unless the taxpayer (1) discontinues doing business[2] and (2) owes back taxes. California Revenue & Taxation Code section 6815 provides:

> *If at the time a business is discontinued the board holds security* pursuant to section 6701 . . . such security when applied to the account of the taxpayer shall be deemed to be a payment on account of any liability of the taxpayer to the board on the date the business is discontinued. (emphasis added)

The Attorney General Opinion (Pet. 13-14) relied upon by petitioner supports respondent's contention that the certificate of deposit was *Sluggo's property*, not petitioner's. The relevant portion explains:

> Such monies are *not State monies* when so deposited . . . .

The funds held by petitioner – which could only legitimately be *used* by petitioner when and if Sluggo's discontinued its business *and* owed past due taxes – were *Sluggo's* funds which would, in the absence of its bankruptcy filing, either have been (1) utilized to satisfy Sluggo's past due taxes *or* (2) refunded to Sluggo's. Thus, the Ninth Circuit and the lower courts were correct in concluding that the certificate of deposit was property of the estate.

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[2] In this case, Sluggo's was still doing business at the time petitioner cashed its certificate of deposit.

III.

CONCLUSION

This case turns on the interpretation of California law, which three competent courts have interpreted in favor of respondent. Petitioner raises no issue which warrants the attention of the United States Supreme Court. In well-reasoned opinions, the courts below correctly determined that Sluggo's certificate of deposit was property of the bankruptcy estate. Petitioner's writ application should therefore be denied.

Dated: 12/21/90

Respectfully submitted,

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